Nos. 75-1870 and 75-1872

In the Supreme Court of the United States

OCTOBER TERM, 1976

E. I. DU PONT DE NEMOURS AND COMPANY AND CHRISTIANA SECURITIES COMPANY, PETITIONERS

v.

RICHARD J. COLLINS, JR. AND LEWIS C. MURTAUGH

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

RICHARD J. COLLINS, JR., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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OPINIONS BELOW

The opinion of the court of appeals is reported at 532 F. 2d 584 (Pet. App. 44a-108a).[1] The opinions

[1] "A." refers to the pages of the appendix filed in this Court. "Pet. App." refers to the appendix to the Commission's petition for a writ of certiorari.

of the Securities and Exchange Commission are not yet reported but are reprinted in Investment Company Act Releases Nos. 8615 and 8692, 5 S.E.C. Docket 745 (Dec. 13, 1974) and 6 S.E.C. Docket 366 (Feb. 27, 1975) (Pet. App. 1a–43a).

JURISDICTION

The judgment of the court of appeals was entered on January 23, 1976 (Pet. App. 109a–110a), and timely petitions for rehearing and suggestions for rehearing *en banc* by the Commission and the intervenors, Christiana Securities Company and E. I. Du Pont de Nemours and Company, were denied on February 26, 1976 (Pet. App. 111a–112a). On May 15, 1976, Mr. Justice Blackmun extended the time for filing a petition for a writ of certiorari to and including June 25, 1976, and on June 26, 1976, further extended the time for filing the petition to and including June 26, 1976. The Securities and Exchange Commission's petition was filed on June 26, 1976. A joint petition by Christiana Securities Company and E. I. Du Pont de Nemours and Company (No. 75–1870) was filed on June 25, 1976. The petitions were granted on October 4, 1976, and the cases were consolidated (A. 1029). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Securities and Exchange Commission, in finding that the terms of a proposed merger of an investment company into an affiliated operating com-

pany were reasonable and fair and do not involve overreaching, reasonably exercised its discretion under the Investment Company Act of 1940 in valuing the investment company essentially on the basis of the market value of its holdings of securities which constituted substantially all of its assets, rather than on a basis reflecting the substantially lower market value of its own outstanding stock.

STATUTES INVOLVED

Sections 2(a)(3), 17(a), 17(b) and 43(a) of the Investment Company Act of 1940, 54 Stat. 791, 815, 844, as amended, 15 U.S.C. 80a–2(a)(3), 80a–17(a), 80a–17(b) and 80a–42(a), are set forth at Pet. App. 113a–116a.

STATEMENT

Section 17 of the Investment Company Act of 1940, 15 U.S.C. 80a–17, governs certain transactions between registered investment companies and "affiliated persons." The Act forbids an affiliated person to purchase any securities or other property from a registered company. Section 17(a)(2). However, the Securities and Exchange Commission may exempt proposed transactions from this prohibition upon application. Section 17(b) provides: "the Commission shall grant such application * * * if evidence establishes that—(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned * * *."

The court of appeals (Pet. App. 110a) set aside a Commission order (Pet. App. 38a–39a), entered pursuant to Section 17(b), which permitted a proposed merger of a registered investment company, Christiana Securities Company ("Christiana"), into its affiliate, E. I. Du Pont de Nemours and Company ("Du Pont").[2]

A. THE PROPOSED MERGER

Christiana is a closed-end, non-diversified management investment company (A. 24).[3] Du Pont is an industrial operating company principally engaged in manufacturing and selling diversified lines of chemical and related products (A. 714–716).

When the Christiana-Du Pont merger negotiations were announced on April 28, 1972, 98 per cent of Christiana's assets consisted of Du Pont common stock—13,417,120 shares—having a market value of $2,198,730,540 (A. 715).[4] This block of stock comprises approximately 28.3 per cent of the outstanding com-

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[2] Section 3 of the Act, 15 U.S.C. 80a–3, defines an investment company to include, *inter alia*, an issuer of stock in the business of investing, owning, holding or trading in securities and owning securities exceeding 40 per cent of its total assets.

Christiana and Du Pont are "affiliated persons" because Christiana owns more than 5 per cent of Du Pont's voting securities. See Section 2(a)(3)(A) and (B) of the Act, 15 U.S.C. 80a–2 (a)(3)(A) and (B).

[3] Section 4 of the Act, 15 U.S.C. 80a–4, classifies investment companies into three categories, one of which consists of management companies; and Section 5, 15 U.S.C. 80a–5, subclassifies management investment companies into open-end and closed-end, diversified and non-diversified companies.

[4] The remaining 2 percent of Christiana's assets consisted of 16,256 shares of Du Pont preferred stock (1 per cent of the outstanding shares—valued at the time of the announcement of the

mon stock of Du Pont, which has approximately 47.5 million shares of common stock outstanding and 225,000 shareholders (A. 27, 87, 710, 761). Du Pont stock is actively traded on the New York and other stock exchanges (Pet. App. 30a, n. 51; A. 716). Under Section 2(a)(9) of the Act, 15 U.S.C. 80a-2(a)(9), Christiana is presumed to be in control of Du Pont.[5]

Christiana itself has 11,710,103 shares of common and 106,500 shares of preferred stock outstanding and about 8,000 shareholders (A. 794). Its stock is traded in the over-the-counter market in relatively limited volume (Pet. App. 30a, n. 51; A. 25, 716). Its earnings are derived almost exclusively from dividends paid on its Du Pont stock (Pet. App. 6a; A. 714). These earnings, after being subject to a 7.2 per cent federal income tax on intercorporate dividends, are almost all distributed to Christiana shareholders as cash dividends (Pet. App. 11a; A. 714).

Because Christiana's assets consist almost entirely of Du Pont stock, the market price of Christiana stock is tied to the market price of Du Pont stock.

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proposed merger at $1,124,102), all of the outstanding stock of a newspaper publisher, The News-Journal Company (7,460 shares—valued at the time of the merger announcement at $24,260,000), 69,216 shares of the Wilmington Trust Company (3.5 per cent of its outstanding shares—valued at the time of the merger announcement at $2,699,424), and net cash and cash equivalents (after payment of liabilities) of $5,981,367 (A. 710, 715, 760-761). These other assets totalled $34,064,893. In addition, Christiana had an income tax refund claim against the United States carried on its books at $11,723,013 (A. 733, 794).

[5] Christiana, however, has denied that it actually controls Du Pont, although it admits its potential to do so (Pet. App. 3a-4a; A. 708).

As is often the case with closed-end investment companies (Pet. App. 5a; A. 815–816), however, Christiana's stock has historically sold at a discount from the market value of its assets, essentially its Du Pont holdings. Over the two years preceding the date on which the merger negotiations were announced, the discount was generally in the range of 20 to 25 per cent, and on the date of the announcement was 23 per cent (Pet. App. 13a).

The discount appears to be primarily tax-related. As noted above, Christiana must pay the federal intercorporate tax on dividends, thereby incurring an expense borne by its shareholders which is not borne by Du Pont shareholders owning their stock directly (Pet. App. 11a–12a). Its owners are also subject to a substantial potential capital gains tax on the unrealized appreciation of Christiana's Du Pont stock, which has a very low tax basis (A. 409–413). In addition, the relatively limited market for Christiana stock may have some influence on the discount (Pet. App. 30a, n 51).[6]

Christiana was formed in 1915 to preserve control over Du Pont by a branch of the du Pont family (Pet. App. 1a–3a). By 1972, Christiana's management concluded that Christiana had outlived its usefulness and that, because of its tax disadvantages and the

[6] Christiana's operational costs of from $200,000 to $300,000 per year for the last several years (A. 623) presumably have had little or no effect on the discount.

discount at which its shares sold, it was desirable that its stockholders become direct, instead of indirect, owners of Du Pont stock. It therefore proposed liquidation of Christiana by means of a merger into Du Pont (Pet. App. 47a–50a).[7]

The proposed merger, in effect, would be a purchase by Du Pont of the assets of Christiana—essentially Du Pont stock—in exchange for Du Pont stock to be issued to Christiana's shareholders. Du Pont would acquire Christiana's $2.2 billion assets and assume its relatively insignificant liabilities (approximately $300,000). It would thus become the owner of the 13,417,120 shares of its common stock which are Christiana's principal assets. Those shares would be retired (A. 711–712). The remaining 2 per cent of Christiana's assets would also be transferred to Du Pont (A. 710).[8]

In exchange, Du Pont would issue 13,228,620 of its shares directly to Christiana shareholders—or 188,-

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[7] Christiana could have been liquidated by distributing its Du Pont stock to its own shareholders as a liquidation dividend. Such a liquidation, however, would involve possibly heavy tax liability for Christiana's shareholders, or, at least, considerable tax uncertainty and tax litigation (Pet. App. 12a, nn. 31 and 32; 24a).

[8] See note 4, *supra*. Du Pont would sell Christiana's bank and newspaper company stock (A. 736–737). An income tax refund claim against the United States, carried on Christiana's books at $11.7 million, was treated as having no value, subject to a contingent distribution of additional Du Pont common stock to former Christiana shareholders upon settlement of the claim (A. 733–736). Du Pont would also acquire and retire the Du Pont preferred stock held by Christiana (A. 711–712).

500 shares fewer than it would receive from Christiana—in a ratio of 1.123 shares of Du Pont for each share of Christiana (A. 710–712), which now represents an indirect holding of 1.15 shares of Du Pont common stock (Pet. App. 10a). Christiana would then disappear as a corporate entity (A. 710). The Internal Revenue Service ruled that the merger will be tax free (Pet. App. 93a, n. 4).

The price to be paid by Du Pont for Christiana's assets is, in substance, 97.5 per cent of the market value of those assets. Specifically, under the terms of the transaction, the shares of Du Pont stock which Du Pont would issue to Christiana's shareholders had a market value equal to 97.5 per cent of Christiana's so-called adjusted net asset value of $2,223,425,827 (A. 714–716, 719–721). The latter amount was calculated by taking the market price of Christiana's Du Pont stock and its other assets (using prices on the New York Stock Exchange for valuing Christiana's holdings of Du Pont stock), subtracting Christiana's insignificant liabilities, and making certain relatively minor adjustments (A. 719–720).

The conversion of the Christiana shareholders' investment into direct instead of indirect ownership of Du Pont shares would increase the market value of the Christiana shareholders' holdings by approximately $450 million. The proposed merger would also benefit Du Pont, which would acquire Christiana's assets at a 2.5 per cent discount from their net value of $2.2 billion, a discount equal to $55.6 million (A. 717, 720–721).

B. THE ADMINISTRATIVE PROCEEDING

Du Pont and Christiana filed a joint application with the Commission for an exemption under Section 17 (A. 24, 81, 111). In the administrative proceeding which followed (A. 10–11), the Commission's Division of Investment Management Regulation [9] also supported the application (Pet. App. 10a). It was opposed by three Du Pont shareholders (*ibid.*), including respondent Collins, and respondent Murtaugh as trustee for two persons (A. 118, 129).

They argued that since Christiana was valued on the basis of its assets, rather than the much lower market price of its outstanding stock, the proposed merger would be unfair to the shareholders of Du Pont because it provides substantially greater benefits to Christiana's shareholders. They also argued that the merger would depress the price of Du Pont stock because it would place more than 13 million Du Pont shares directly in the hands of Christiana shareholders, who would then have the opportunity to sell those shares. They proposed that, if the transaction were to be permitted at all, the Commission should require modification of the merger terms to give Du Pont a substantial share of the gain to Christiana shareholders from elimination of the 23 per cent discount from net asset value (*i.e.,* the market price of Du Pont stock) at which Christiana's stock was selling (Pet. App. 10a–16a).

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[9] Now the Division of Investment Management.

After the hearing, at which approximately 1,000 pages of testimony were taken and 50 exhibits were introduced, the parties waived the initial decision by the administrative law judge, and the record was submitted to the Commission (A. 616). The Commission unanimously granted the application (Pet. App. 38a). It viewed the proposed transaction as an exchange of equivalents: Christiana's Du Pont stock to be acquired by Du Pont in exchange for Du Pont stock to be issued directly to Christiana shareholders (Pet. App. 9a). It held that, in determining under Section 17(b) whether the terms of the merger "are reasonable and fair and do not involve overreaching on the part of any person concerned," the proper guide for valuing Christiana was the market price of Christiana's holdings of Du Pont stock (Pet. App. 32a):

> An investment company, whose assets consist entirely or almost entirely of securities the prices of which are determined in active and continuous markets, can normally be presumed to be worth its net asset value.

The Commission held that the fairness of the terms of the proposed merger is not affected by the possibility that Du Pont might have obtained more favorable terms through its strategic bargaining position because of tax disadvantages to Christiana and its shareholders from other methods of liquidating Christiana (Pet. App. 24a). On the contrary, the Commission stated, the purpose of Section 17 is to prevent persons in a strategic position from getting more than fair value (Pet. App. 24a–25a).

The Commission found that the transaction would result in no detriment to Du Pont or to the value of its outstanding shares (Pet. App. 20a, 26a, 28a). With respect to the objectors' fears that the price of Du Pont stock would be depressed, the Commission concluded that the intrinsic value of an investment in Du Pont would not be altered by the merger, and, accordingly, that any depressing effects on the price of Du Pont common stock would be of brief duration (Pet. App. 29a). The Commission pointed out that where, as here, it is considering a fundamental corporate readjustment, the interests of short-term speculators must yield to those of long-term investors (Pet. App. 27a).

The Commission concluded that any valuation involving a significant departure from net asset value would be unfair, because it would strip long-term investors in companies like Christiana of the intrinsic worth of the securities which underlie their holdings (Pet. App. 33a). Although the 2.5 per cent difference between the value of the assets that would be given by Christiana to Du Pont, and of the Du Pont stock that would be given to the Christiana shareholders by Du Pont, was within the range of fairness, an appreciably higher discount would "run afoul of Section 17(b)(1) of the Act" (Pet. App. 36a). Since the merger could not harm Du Pont and since the 2.5 per cent discount enabled Du Pont to obtain Christiana's assets below their market price while nevertheless insuring that Christiana would receive the substantial

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equivalent of what it would give up, the terms and conditions of the proposed transaction were reasonable and fair, whether or not they (1) resulted from arm's length bargaining, or (2) were the same as those which unrelated and unregulated parties might have reached (Pet. App. 35a–36a).

C. THE DECISION OF THE COURT OF APPEALS

A divided court of appeals set aside the Commission's decision (Pet. App. 45a). The court held that the Commission had erred as a matter of law in ruling that Christiana "should presumptively be valued on the basis of the market value of its principal asset, common stock of Du Pont" (*ibid.*). It ruled that the Commission should have considered and given substantial weight to "the value of what the Christiana shareholders are giving in the exchange" (Pet. App. 56a), which, in its view, was the current market value of Christiana's outstanding stock and not the market value of its securities holdings (Pet. App. 54a, 56a, 68a, 86a). It held that Section 17 requires that the terms of a merger between an investment company and its affiliate must be within the range of an arm's length bargain (Pet. App. 61a), that this proposed transaction is not within that range (Pet. App. 73a–91a), and that accordingly the Commission's determination that the proposed transaction satisfied Section 17 was invalid.

Judge Stephenson, dissenting, agreed with the Commission that the merger involved an exchange of equivalents (Pet. App. 92a–93a), and that the proper

measure of the value of an investment company is its net asset value (Pet. App. 98a–99a). He concluded that the Commission properly adopted this standard under Section 17. Quoting from *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 209, he concluded that the determination of fairness is " 'in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts' " (Pet. App. 99a). In Judge Stephenson's view, the court of appeals could not reverse the Commission's determination of fairness unless the Commission had clearly abused its discretion. He stated that the agency had acted within its discretion in concluding that a discount from Christiana's net asset value appreciably higher than the 2.5 per cent the Commission found fair " 'would divest Christiana stockholders of a significant portion of the intrinsic investment values to which they are legally and equitably entitled' and thus 'runs afoul of the Act' " (Pet. App. 101a).

An equally divided court denied rehearing *en banc* (Pet. App. 111a–112a).

SUMMARY OF ARGUMENT

In Section 17(a) of the Investment Company Act of 1940, Congress prohibited the sale or transfer of securities and other property between investment companies and their affiliates unless the Securities and Exchange Commission exempts the proposed transaction under Section 17(b) upon finding that its terms, "including the consideration to be paid or received, are reasonable and fair and do not involve

overreaching on the part of any person concerned." As in other statutes protecting the public against commercial overreaching and unfairness, Congress assigned to a regulatory agency responsibility for applying its broad statutory guidelines to particular situations. Under such a statutory scheme, judicial review is limited to determining whether the agency's decision has warrant in the record and a reasonable basis in law, and great weight is given to the Commission's expert assessment. *Atlantic Refining Co.* v. *Federal Trade Commission,* 381 U.S. 357, 367–368; *Securities and Exchange Commission* v. *Chenery Corp.,* 332 U.S. 194, 207–208.

In this case, the Commission's exemption of the Christiana-Du Pont merger was supported by the record and had a rational legal basis. The court of appeals, however, incorrectly substituted its view for the Commission's by determining *de novo* the technical issues governing the valuation of investment companies.

A. There is a significant difference between the selling price of an investment company and that of a manufacturing or service business with going-concern value. The market or liquidation value of any company's assets is the minimum for which the company will be sold, because it would normally be economically irrational for the owners to sell for less. The value of an operating company usually will exceed this minimum because of its earnings capacity as an on-going concern. This value is reflected in the

market price of its stock. The price of an operating company's stock is therefore relevant in valuing it for merger purposes.

Investment companies, however, ordinarily have no going-concern value. They are simply a portfolio of securities. When an investment company is liquidated by merger or otherwise, the value of its assets is their market price. The fact that its own stock is selling for less is irrelevant in such a liquidation, and the net value of its assets—*i.e.*, the market price of its securities portfolio, less liabilities—is the proper basis for valuing the company under Section 17(b).

The Commission correctly applied these principles to the Du Pont-Christiana merger. The merger will effect a liquidation of Christiana by sale of its assets (Du Pont stock) to the Du Pont Company in return for Du Pont stock to be issued directly to Christiana's shareholders by Du Pont. The consideration would thus be an exchange of equivalents. The court of appeals misunderstood this. It erroneously assumed that Christiana's own stock was part of the exchange. But that stock's only role will be to determine the number of shares of Du Pont each Christiana shareholder will receive. Its market price is therefore irrelevant in determining whether the terms and consideration for the transaction are reasonable and fair and free from overreaching.

B. Since the proposed transaction is a liquidation of the investment company, Christiana should be valued on the basis of what it is contributing to the

transaction—its net asset value measured by the market price of its Du Pont holdings. This result is not changed because, for tax reasons, (1) Christiana stock traditionally has sold at a substantial discount below Du Pont stock, and (2) Christiana cannot, as a practical matter, liquidate by distributing its Du Pont holdings directly to its shareholders. While Christiana's tax disadvantages might give Du Pont a strategic bargaining advantage, a purpose of Section 17 is to prevent persons in such a position from paying less than the fair value of what they acquire at the expense of disadvantaged investors. For the same reason, the fact that unregulated parties might exercise such leverage to their own advantage in an arm's-length transaction, does not invalidate the Commission's conclusion that Christiana's assets should be transferred to Du Pont at their market price.

Neither Du Pont nor its stockholders will suffer any detriment from the merger. To the contrary, Du Pont will acquire assets with a market price of $2.2 billion at a discount of $55.6 million. On the other hand, if Du Pont were to acquire Christiana's Du Pont stock for substantially less than it is paying, the transaction would be unfair to Christiana's shareholders. The Commission correctly found that the transaction is reasonable and fair and free from overreaching by either side.

C. The Commission's conclusion is supported by its settled administrative interpretation under Section 17(b), and similar provisions in other statutes, that the market value of an investment company's port-

folio is the proper basis for valuing the company. See, *e.g.*, *Central States Electric Corp.*, 30 S.E.C. 680 (advisory report in Chapter X reorganization), approved, *Central States Electric Corp.* v. *Austrian*, 183 F. 2d 879, 884 (C.A. 4), certiorari denied, 340 U.S. 917. The court of appeals should have followed this authoritative construction of the statute by the agency charged with its administration.

ARGUMENT

THE SECURITIES AND EXCHANGE COMMISSION PROPERLY DETERMINED THAT THE TERMS OF THE PROPOSED MERGER ARE REASONABLE AND FAIR AND DO NOT INVOLVE OVERREACHING

One of the major "problems and abuses" in the management and operation of investment companies disclosed by the Commission's "intensive scrutiny of the industry" in its Investment Trust Study (*United States* v. *National Association of Securities Dealers*, 422 U.S. 694, 704) was the widespread existence of dealings and transactions among investment companies and persons affiliated with them, by which insiders were able to take advantage of their position to the detriment of public investors.[10] A principal reform that resulted from that study was the prohibition in Section 17(a) of the Investment Company

[10] See generally *Report on Investment Trusts and Investment Companies*, Pt. III, ch. IV, "Problems in Connection with Shifts in Control, Mergers, and Consolidations of Investment Companies," H.R. Doc. No. 279, 76th Cong., 1st Sess., pp. 1017–1562 (1939).

Act, 15 U.S.C. 80a-17(a), of transactions involving the sale or other transfers of securities and other property between investment companies and their affiliates, unless the Commission exempted the transaction from the prohibition under the standards specified in Section 17(b). That section requires the Commission to exempt a transaction between an investment company and its affiliate if other conditions are met [11] and the evidence establishes that

> the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned * * *.

Congress did not attempt to define what constitutes "reasonable and fair" terms or "overreaching" in such a transaction, or to specify the standards or bases upon which the Commission is to make those determinations. Indeed, given the nature of the investment company business and the wide variety of possible transactions between investment companies and their affiliates, it would have been virtually impossible for Congress to have defined in advance the precise meaning, conditions and application of those terms.[12]

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[11] The transaction must be consistent with the investment company's policy, and the general purposes of the Act. Section 17(b)(2), (3).

[12] The court of appeals stated that "Congress could have simply decreed that a merger of a closed-end, non-diversified investment company into its portfolio affiliate is reasonable and fair when the investment company is valued at or close to its net asset value" (Pet. App. 55a). But Section 17 governs all types of transactions—not just mergers involving transfers of securities or

In Section 17(b) Congress thus followed the practice it has frequently employed in other statutes designed to protect the public against commercial overreaching or unfairness. It formulated broad statutory prohibitions and guidelines but assigned to an expert administrative agency the essentially empiric task of applying those criteria to particular situations. See, *e.g., Federal Trade Commission* v. *Sperry & Hutchinson Co.,* 40 U.S. 233, 239–244 (unfair and deceptive trade practices); *Yakus* v. *United States,* 321 U.S. 414, 427 (fair and equitable prices); *Lichter* v. *United States,* 334 U.S. 742, 778–786 (excessive profits); *Board of Trade* v. *United States,* 314 U.S. 534, 546–547 (reasonableness of rail rates). Where, as here,

> the Congress has provided that an administrative agency initially apply a broad statutory term to a particular situation, our function is limited to determining whether the Commission's decision "has 'warrant in the record' and a reasonable basis in law." *Labor Board* v.

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other property among investment companies and their affiliates—and is not limited to transactions with closed-end non-diversified companies. It even covers transactions between affiliates of an investment company with each other, or with an affiliate of an affiliate. It does not attempt to specify what would be reasonable and fair in any particular type of transfer, but leaves it to the Commission to determine, on the basis of its expertise, the fairness of all transactions that Section 17 covers. See text, *supra.*

Indeed, the Commission would not have treated the Du Pont-Christiana merger as subject to Section 17 prior to 1953, when the Commission first held that a statutory merger constitutes a sale within the meaning of Section 17 of the Act. *E. I. du Pont de Nemours and Co.*, 34 S.E.C. 531, overruling *Phoenix Securities Corporation*, 9 S.E.C. 241 (Pet. App. 8a, n. 20).

> *Hearst Publications, Inc.*, 322 U.S. 111, 131 (1944). While the final word is left to the courts, necessarily "we give great weight to the Commission's conclusion. . . ." *Federal Trade Comm'n* v. *Cement Institute, supra* [333 U.S. 683] at 720. [*Atlantic Refining Co.* v. *Federal Trade Commission*, 381 U.S. 357, 367–368.]

This Court frequently has recognized the limited scope of judicial review of Commission determinations of the fairness and reasonableness of various corporate transactions under similar broad statutory standards. *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 207–208; *Securities and Exchange Commission* v. *Central-Illinois Securities Corp.*, 338 U.S. 96, 113, 126–127; *Niagara Hudson Power Corp.* v. *Leventritt*, 340 U.S. 336, 347. In the latter two cases the Court sustained Commission determinations that, like the one in this case, primarily involved the basis for valuing particular enterprises and their securities.

In *Chenery, supra*, 332 U.S. at 208–209, the Court explained the reason for the limited scope of judicial review of such determinations:

> The very breadth of the statutory language precludes a reversal of the Commission's judgment save where it has plainly abused its discretion in these matters. * * *
>
> * * * * *
>
> The Commission's conclusion here rests squarely in that area where administrative judgments are entitled to the greatest amount of weight by appellate courts. It is the product

of administrative experience, appreciation of the complexities of the problem, realization of the statutory policies, and responsible treatment of the uncontested facts. It is the type of judgment which administrative agencies are best equipped to make and which justifies the use of the administrative process. See *Republic Aviation Corp.* v. *Labor Board,* 324 U.S. 793, 800. Whether we agree or disagree with the result reached, it is an allowable judgment which we cannot disturb.

As we now show, the Commission's conclusion that the terms of the Du Pont-Christiana merger are "reasonable and fair and do not involve overreaching" satisfies the requirement that they have "'warrant in the record' and a reasonable basis in law." Under its limited function in reviewing those determinations, therefore, the court of appeals should have upheld the Commission's order approving the merger. Instead, the court itself undertook to decide *de novo* technical questions the correct resolution of which requires intimate and specialized knowledge of the investment company business, and which under the statute are committed primarily to the agency's discretion.[13]

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[13] The court's error is underlined by its unusual step of appointing a "contract consultant," whose duties "were to assist the Court in understanding the record in this case and to prepare reports and memoranda for this Court in connection with that function" (Pet. App. 91a, n. 40). If the court believed that it needed clarification or assistance in understanding the record, the appropriate procedure was to remand to the Commission. See *Berko* v. *Securities and Exchange Commission*, 297 F. 2d 116, 118–119 (C.A. 2), where then Circuit Judge Marshall pointed to

A. THE PRACTICAL EFFECT OF THE MERGER IS THAT CHRISTIANA WILL BE LIQUIDATED, DU PONT WILL ACQUIRE CHRISTIANA'S PORTFOLIO OF SECURITIES AT THEIR MARKET VALUE, AND CHRISTIANA'S SHAREHOLDERS WILL EXCHANGE THEIR INDIRECT HOLDINGS OF DU PONT STOCK FOR DIRECT HOLDINGS THEREOF

When one company acquires another by purchase of its assets and assumption of its liabilities, the net market value of its assets is the minimum selling price because it would normally be economically irrational for the owners to sell for less.[14] In the case of operating companies, the price will normally exceed net asset value by an amount reflecting the earnings capacity of the acquired enterprise as an ongoing business. The market price of the acquired company's stock is relevant to this value, because it reflects the market's estimate of the company's anticipated future earnings as a going concern.[15]

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the differences in the functions of a court of appeals' reviewing a decision of a lower court and reviewing that of an administrative agency, concluding in a case involving the latter situation:

"Because this case raises substantial questions, and we believe clarification necessary, we must remand."

See also *District 65, Retail, Wholesale and Department Store Union* v. *National Labor Relations Board*, 294 F. 2d 364, 370 (C.A. 3); 2 Davis, *Administrative Law Treatise*, §§ 16.05, 16.12 (1958).

[14] Pratt and Hugo, "Pricing a Company by the Discounted Future Earnings Method," 7 *Mergers and Acquisitions* 18 (1972).

[15] Pratt and Hugo, *supra;* Alberts and Segall, *The Corporate Merger*, p. 139 (1966); McCarthy, *Acquisitions and Mergers*, pp. 73, 77–78 (1963); Scharf, *Techniques for Buying, Selling and Merging Businesses*, pp. 44, 53 (1964).

Investment companies, on the other hand, normally have no going-concern value. In its 1939 study of Investment Trusts and Investment Companies, which formed the basis of the Act (*United States* v. *National Association of Securities Dealers,* 422 U.S. 694, 704–706), the Commission noted:

> [A]sset value, which does not take going concern value into account, is much more applicable to investment companies than to manufacturing or merchandising concerns for which good-will and similar intangibles are of great importance in reaching adequate valuations.[16]

Investment companies are essentially a portfolio of securities, the price of which is generally determined by the disinterested auction process prevailing on the nation's securities markets. See, *e.g., Central States Electric Corp.,* 30 S.E.C. 680, 699–670. The liquidation value of those securities is the same no matter who is the buyer or the seller or what the tax consequences to the seller may be. The merger of an investment company into its affiliate is in practical effect a liquidation of its securities holdings. The value of an investment company in such an acquisition, therefore, is appropriately measured by the price of those securities on the securities markets.

By liquidating Christiana through its merger with Du Pont, the latter will acquire Christiana's portfolio of securities. Christiana has no going-concern

[16] *Report on Investment Trusts and Investment Companies,* Pt. II, H.R. Doc. No. 70, 76th Cong., 1st Sess., p. 321 (1939).

value; its only value to Du Pont is the value of Christiana's securities portfolio. Du Pont is in effect purchasing Christiana's Du Pont stock at a price substantially equivalent to the market price of that stock. Thus, as the Commission pointed out (Pet. App. 9a), the merger will involve an exchange of equivalents.

Under the terms of the merger, the Christiana shareholders will, in practical effect, exchange their indirect interest in the Du Pont stock, held through Christiana, for a direct interest in that stock.

B. THE COMMISSION PROPERLY CONCLUDED THAT THE TERMS OF THE MERGER ARE "REASONABLE AND FAIR AND DO NOT INVOLVE OVERREACHING" BECAUSE THE VALUE OF THE DU PONT STOCK THAT THE CHRISTIANA SHAREHOLDERS WILL RECEIVE IS SUBSTANTIALLY EQUIVALENT TO THE VALUE OF THE CHRISTIANA ASSETS THAT DU PONT WILL ACQUIRE

1. THE COMMISSION CORRECTLY DETERMINED THAT THE PROPER BASIS FOR VALUING AN INVESTMENT COMPANY UPON ITS LIQUIDATION THROUGH A MERGER WITH ITS AFFILIATE IS THE MARKET VALUE OF THE INVESTMENT COMPANY'S PORTFOLIO OF SECURITIES AND NOT THE LOWER MARKET PRICE AT WHICH THE INVESTMENT COMPANY'S OWN SHARES TRADITIONALLY HAVE SOLD

a. The purpose of the requirement in Section 17(b) that the Commission approve only those transactions between investment companies and their affiliates that are "reasonable and fair and do not involve overreaching" is to prevent overreaching by persons in a strategic position. This includes preventing them from paying less than the fair value of the assets they receive from the investment company at the expense of disadvantaged investors.

As noted, the effect of the merger is that Du Pont will acquire Christiana's holdings of Du Pont stock for the market value of those shares, and that the Christiana shareholders will exchange their indirect holdings of Du Pont stock for direct holdings on the basis of the value of their interest in Christiana's assets. The basic position of the Christiana shareholders will be no different than if Christiana had distributed its Du Pont holdings directly to the Christiana shareholders, rather than transferring those holdings to Du Pont, which then will issue its own stock to the Christiana shareholders. In either situation, the transaction is a method of distributing to the investment company shareholders the underlying portfolio of their company, and the fair measure of what they are to receive is the value of those assets.[17]

If Christiana had followed the typical pattern of corporate liquidation—either selling its Du Pont shares on the open market and then distributing the cash to its stockholders, or itself directly distributing the Du Pont stock to them—Christiana shareholders would have received the value of the portfolio shares. Because of tax reasons (see *supra*, p. 7, n. 7), however, Christiana seeks to liquidate through a merger. But the particular form the transaction takes does not change its fundamental character.

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[17] Although in Section 17(b) Congress did not define fair value, it provided in Section 2(a)(41)(B) 15 U.S.C. 80a-2(a)(41)(B), that "'[v]alue', with respect to assets of registered investment companies, * * * means * * * with respect to securities for which market quotations are readily available, the market value of such securities * * *."

The Commission realistically viewed Christiana as being substantially equivalent to its Du Pont holdings, and determined that any substantial departure from the value of that Du Pont stock as a basis for valuing Christiana would ignore the economic realities. It follows that since the transaction itself will result essentially in "an exchange of equivalents" (Pet. App. 9a)—Du Pont common stock for Du Pont common stock—it would be contrary to basic notions of fairness to value the Du Pont stock on one side of the transaction on a basis substantially different from that used in valuing the stock on the other side.

The court of appeals reasoned that Section 17(b)(1) requires the Commission to "look to the value of what the Christiana shareholders are giving in the exchange" (Pet. App. 56a); it concluded that what was being given was Christiana stock, not Du Pont stock owned by Christiana. The court stated (*id.* at 58a): "It is the current worth of the Christiana stock given in exchange for the Du Pont stock that must be determined in order to pass on the reasonableness and fairness of the merger."

This characterization of the transaction is incorrect. No Christiana stock is to be given to Du Pont in exchange for anything. What is to be given in exchange for the stock issued by Du Pont is the Du Pont stock and other assets owned by Christiana. For, as we have shown, pp. 22–23, *supra,* the value of an investment company, unlike an operating company, consists only of its assets.

This misconception permeates the court of appeals' decision. That decision constantly emphasizes the current value of the Christiana stock. In this merger, however, the shareholders of the acquired corporation are not transferring the stock in their company but its assets. The Christiana stock is not the consideration in the transaction between Du Pont and Christiana—the consideration is the Du Pont stock Christiana owns. The only role of the Christiana stock in the merger is to define the number of shares of Du Pont stock the Christiana shareholders will receive (A. 711).

The requirement of reasonableness and fairness in Section 17(b) does not contemplate that the Christiana shareholders should receive substantially less than the fair value of their share of Christiana's assets when Christiana is liquidated and those assets in effect are distributed to them. To permit Du Pont to acquire Christiana's assets for substantially less than their true value, as shown by their market price, would be to sanction the very kind of "overreaching on the part of" Christiana's affiliate Du Pont that Section 17(b) is intended to prevent.

b. The court of appeals concluded that under Section 17(b) fairness should be defined in terms of the bargain the parties would reach through arm's-length negotiations. The court reasoned that, since Du Pont has a strategic bargaining position resulting from the tax disadvantages of Christiana and from the unfavorable position of Christiana shareholders because

of the substantial discount at which Christiana stock has traditionally sold, the terms of the merger must reflect this bargaining advantage as the price for liquidation of Christiana by absorption into Du Pont.

There is nothing in the Act that supports this interpretation of Section 17(b). On the contrary, the court of appeals' construction would violate the basic purpose of that provision by maximizing the opportunities for exploiting any leverage one party to a merger may have, thus enabling affiliates in strategically advantageous bargaining positions to obtain windfalls at the expense of public investors.

Since the Du Pont-Christiana merger will effect a liquidation of Christiana, the fact that the latter's own shares, like those of most closed-end investment companies, have traditionally sold at a substantial discount (23 per cent) from the market price of the Du Pont stock that constitutes Christiana's principal asset is irrelevant. Christiana's stock is not the basis for the transaction.

Furthermore, the Commission's conclusion that the terms of the merger are reasonable and fair and do not involve overreaching is not undermined because, for tax reasons, the Christiana shareholders are benefited more from the merger than the Du Pont shareholders. The special advantage that the Christiana shareholders will derive from the merger, although not similarly available to the Du Pont stockholders, does not make the merger unfair to the latter. As the Commission pointed out (Pet. App. 24a), the stock-

holders of Du Pont "have no property interest in the Christiana stockholders' tax problems." Because of the situation of one party, a transaction may have particular advantages and benefits for that party that are not available to the other party. That fact, however, does not render the transaction unfair to the latter.[18]

Du Pont's acquisition of Christiana's assets at substantially their market value would cause no injury or hardship for Du Pont's stockholders. Indeed, Du Pont would benefit by $55.6 million (see *supra*, p. 8). The possibility that an affiliate might obtain more favorable terms in an unregulated arm's-length transaction is not one of the elements of value that Congress intended the Commission to recognize in Section 17(b). To the contrary, it is the kind of overreaching that section prohibits.

The court of appeals stated that "the Commission should have accorded * * * some weight" "to the factor of occasional detriment to Du Pont shareholders"

[18] See *Lahti* v. *New England Power Ass'n*, 160 F. 2d 845, 851–852 (C.A. 1), which held that in determining whether a plan for simplification of a public utility holding company was "fair and equitable" within the meaning of Section 11(e) of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79k(e), the Commission was not required to take into account individual tax consequences upon the various shareholders. The court explained that the Act's requirements that the Commission pass on the fairness of the transaction—similar to the Investment Company Act's "reasonable and fair" test—does not put "this impossible burden upon the Commission" (160 F. 2d at 852).

In *West Penn Power Company*, 42 S.E.C. 412, 429–430, the Commission again determined, under the Holding Company Act, not to take into account individual tax consequences.

who may have been "tape watchers," although it agreed that such detriment was "minimal" (Pet. App. 90a, 91a). As the Commission recognized, however, even if the market for Du Pont stock might "at certain points in time" be adversely affected as a result of the merger, "the transitory market phenomena are of secondary significance" (Pet. App. 26a, 27a). Under Section 17, as in reorganizations under the Public Utility Holding Company Act and Chapter X of the Bankruptcy Act, the emphasis must be on "intrinsic value" at the expense of "market factors" (Pet. App. 27a–28a, n. 49). See, *infra*, pp. 33–36. As the Commission held (Pet. App. 28a), the intrinsic value of an investment in Du Pont could not be adversely affected by the merger, since the merger would not detract from Du Pont's assets or earnings.

Pepper v. *Litton*, 308 U.S. 295, upon which the court of appeals relied (Pet. App. 61a), is not inconsistent with the Commission's decision. That case, which arose under the Bankruptcy Act and not the Investment Company Act, held that in dealing with his corporation, a controlling shareholder may not engage in transactions which operate to the corporation's detriment. Since the dissolution of Christiana through this merger would not operate to Du Pont's detriment, the terms of the proposed merger are not inconsistent with the *Pepper* standard. *Pepper* does not mean that, to be reasonable and fair, the Du Pont-Christiana merger must deprive Christiana and its shareholders of a substantial portion of the value

of their property merely because in an unregulated arm's-length transaction Du Pont might have exacted a price that would have done so.

The court of appeals stated that certain du Pont family members previously chose not to realize the net asset value of their shares in order to "retain economic, political and social advantages that accompanies [sic] control of one of America's largest industrial concerns," and that they "cannot now be heard to complain that the tax laws of the United States have affected the market value of their stock" (Pet. App. 87a). This factor is irrelevant under the Investment Company Act. The particular situation of some du Pont family members is not a pertinent consideration under Section 17(b) (see *supra*, pp. 28–30). In analyzing the merger, the Commission had to assure that the transaction is fair both to the 8,000 Christiana shareholders, many of whom are unrelated to the du Ponts who set up Christiana, and to the shareholders of the Du Pont Company.

c. The court of appeals suggested (Pet. App. 67a–72a) that its analysis was supported by cases under the Interstate Commerce Act, the Public Utility Holding Company Act, the Bankruptcy Act, and the Internal Revenue Code. Whatever may the criteria of these statutes, net asset value is the standard of the Investment Company Act. In any event, the Commission's decision is not inconsistent with those cases.

For example, the court of appeals cited cases under the Public Utility Holding Company Act and the

Bankruptcy Act for the proposition that "[t]he inquiry must be both independent and thorough, giving consideration to all factors affecting the value of what the Christiana shareholders are contributing" (Pet. App. 68a). But this proposition supports the Commission's analysis, because what the Christiana shareholders would contribute is the assets of their company—its holdings of Du Pont stock.

Schwabacher v. *United States,* 334 U.S. 182, cited by the court of appeals as militating against acceptance of the Commission's position (Pet. App. 67a–68a), held that fairness under Section 5 of the Interstate Commerce Act is to be governed by the value—in terms of current worth—of the shareholders' contribution to the merger. 334 U.S. at 199. This holding is fully consistent with the Commission's decision here because the current worth of the contribution of the shareholders of Christiana is the net asset value of the securities—essentially the Du Pont stock—that Du Pont will acquire. Moreover, *Schwabacher* did not involve liquidation of an investment company, but the voluntary merger of two on-going concerns, operating railroads, into one corporation.

The method of valuing property under the Internal Revenue Code is governed by specific regulations requiring valuation at the estimated arm's-length bargaining price. But, as this Court held in *United States* v. *Cartwright,* 411 U.S. 546, which the court of appeals cited (Pet. App. 69a), that price must be determined in the correct market, *i.e.,* the market in

which the property being transferred is traded. *Cartwright* involved the valuation of open-end investment company shares, which the issuing company was required to redeem at net asset value. Hence, that value is always the basis for the market price. Here, the property being transferred is Christiana's holdings of Du Pont stock, at a net asset value reflecting the price of those securities on the market where they are traded.[19]

2. THE COMMISSION'S SETTLED INTERPRETATION OF SECTION 17(b) AND OF SIMILAR PROVISIONS OF OTHER STATUTES IT ADMINISTERS CONFIRMS THAT UNDER THAT SECTION THE MARKET VALUE OF AN INVESTMENT COMPANY'S SECURITIES PORTFOLIO IS THE PRIMARY FACTOR IN VALUING THE COMPANY

a. In view of the foregoing considerations, it is hardly surprising that over the years the Commission has consistently approved, as "reasonable and fair and not involving overreaching," investment company mergers in which the terms primarily reflected the net asset value of the companies. Its settled position has been, as in the application of other provisions of the federal securities laws (cf. *Niagara Hudson Power Corp.* v. *Leventritt,* 340 U.S. 336, 346–348; *Securities and Exchange Commission* v. *Central-Illinois Securi-*

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[19] The court of appeals also cited two tax cases, *Paulina Du Pont Dean* v. *Commissioner*, 19 T.C.M. 281, and *Mary A. B. Du Pont Laird* v. *Commissioner*, 38 B.T.A. 926. In both cases, Christiana common stock was valued not at net asset value but at the lower market prices for such stock. Those cases are not inconsistent with the Commission's decision here because they involved transfers of Christiana's stock itself, not, as in this case, transfers of Christiana's assets.

ties Corp., 338 U.S. 96, 152), that in such transactions the true economic value of the assets is the major criterion for determining fairness and that the leverage of parties to an acquisition who have strategic bargaining advantages cannot be recognized.[20]

The Commission also has applied this principle in cases under other statutory provisions involving similar policies and considerations. In *Central States Electric Corp.*, 30 S.E.C. 680, the Commission, pur-

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[20] There have been a number of cases in which the Commission approved, often without discussion, investment company mergers with affiliates where the merger terms provided that the investment company's value would be based on its net asset value. These include the following: *Cheapside Dollar Fund*, Investment Company Act Releases Nos. 9038 and 9085 (1975); *Chemical Fund*, Investment Company Act Releases Nos. 8773 and 8795 (1975); *ELT, Inc.*, Investment Company Act Releases Nos. 8675 and 8714 (1975); *The Citizens and Southern Capital Corporation*, Investment Company Act Releases Nos. 7755 and 7802 (1973); *Abacus Fund, Inc.*, Investment Company Act Releases Nos. 7053 and 7094 (1972); *Huyler's*, Investment Company Act Releases Nos. 5773 and 5809 (1969); *Eastern States Corporation*, Investment Company Act Releases Nos. 5693 and 5711 (1969); *Townsend Corp.*, 42 S.E.C. 282; *Harbor Plywood Corporation*, 40 S.E.C. 1002; *Delaware Realty and Investment Company*, 40 S.E.C. 469; *Detroit and Cleveland Navigation Company*, Investment Company Act Releases Nos. 3082 and 3099 (1960); *International Mining Corporation*, 37 S.E.C. 209. In several of these cases the investment company's own stock traded at a substantial discount from the company's net asset value.

We have found no case where the merging investment company has not been valued, to the extent its assets were readily marketable securities, on the basis of the market price for those securities.

While a number of the foregoing cases were uncontested, an agency's consistent administrative interpretation may be established by consent orders as well as by litigated decisions. *Federal Trade Commission* v. *Mandel Bros.*, 359 U.S. 385, 391.

suant to Chapter X of the Bankruptcy Act, issued an advisory report to the district court on the reorganization of Central States Electric Corporation, a closed-end investment company with assets consisting primarily of controlling stock interests in two other closed-end investment companies. The outstanding stock of the two investment company subsidiaries, like the stock of Christiana in the present case, had generally been traded in the market at discounts from the net asset value of the subsidiaries' portfolio securities (*id.* at 700–701). If Central States had been valued on the basis of the market price of the subsidiaries' stock, Central States' value would have been $31,225,000, while a valuation based on the higher net asset value of the subsidiaries' portfolio securities would have been $34,965,000 (*id.* at 701).

In using the higher valuation, the Commission stated that "it is natural that net asset value based upon market prices [of the assets] should be the fundamental valuation criterion * * * in the investment company field" (*id.* at 700) and that "[i]n fact this method of valuation is a basic requirement of the Investment Company Act" (*id.* at 700, n. 11). Both the district court and the court of appeals accepted the Commission's theory. *Central States Electric Corp.* v. *Austrian,* 183 F. 2d 879, 884 (C.A. 4), certiorari denied, 340 U.S. 917. The court of appeals concluded that "the proper method of valuing the assets of an investment company such as this is not prospective earnings, as in the case of a manufacturing or railroad

corporation, but the presently realizable market values of the securities on hand." 183 F. 2d at 884.

b. The court of appeals concluded in this case, however, that the Commission's interpretation of the Act has not been consistent, and accordingly that it was "not here confronted with a consistent interpretation of the Act by the agency charged with its enforcement meriting deference by a reviewing court" (Pet. App. 66a). The court has misinterpreted those agency decisions.

The court cited various Commission decisions in which it believed the agency had approved transactions in which investment companies were valued on the basis of factors other than net asset value (Pet. App. 62a). In some of those cases, the other factors to which the court referred did not result in departures from net asset value, but rather were taken into account in determining net asset value. Thus, in *Townsend Corp.,* 42 S.E.C. 282, 286, 294–295, 312, the investment company's earnings were not, as the court of appeals stated (Pet. App. 62a), used as a separate valuation factor different from asset value; rather, they were used to compute the value of some of the investment company's stock holdings in certain operating subsidiaries whose stock did not have an active market because the subsidiaries were wholly or almost wholly owned by the investment company (*id.* at 286, 294–295).

In its discussion of *Central States Electric Corp.,* 30 S.E.C. 680, the court of appeals stated that the capital gains tax on the unrealized appreciation of

assets was used to depart from net asset value. The potential capital gains tax in that case, however, was an immediate potential liability of the company, which had to be subtracted from gross asset value to determine net asset value.[21] *Id.* at 721–722, 733–735. As noted at page 35, *supra,* the Commission based its valuation on the net asset value of the subsidiary investment companies' portfolios.

In *Harbor Plywood Corporation,* 40 S.E.C. 1002, since one of the assets of the investment company was a claim that was in litigation, there was included in the valuation of the investment company an amount that was "essentially attributable to the settlement of the lawsuit." *Id.* at 1012; see, also, *id.* at 1005–1006, 1008.

International Mining Corporation, 37 S.E.C. 209,
In ~~*Harbor Plywood Corporation,* 40 S.E.C. 1002,~~ the investment company stock was traded substantially *above* its net asset value (*id.* at 225). It was suggested that this indicated that the investment company was worth more than its net asset value. Although the Commission stated that the market price of the stocks of companies engaging in Section 17 transactions are an important—but not controlling—factor to consider (*ibid.*), it actually valued the in-

[21] A similar tax consideration was taken into account in computing Christiana's net asset value. Under the terms of the merger, Du Pont would acquire Christiana's bank and newspaper stock. Because it would acquire Christiana's tax basis in this stock and because it intends to dispose of the stock, the net asset value of Christiana assets for purposes of the merger was reduced by the amount of the anticipated tax to be incurred upon the disposition of the securities (A. 720, 736–737).

vestment company upon the basis of its net asset value. *Id.* at 215, 224–225.

The remaining cases the court cited as reflecting departures from net asset value (Pet. App. 62a–66a) either did not involve the valuation of investment companies at all [22] or involved the valuation of companies which, although registered under the Act as investment companies, were actually of a hybrid nature—*i.e.,* part investment company and part an operating business.[23]

The court also suggested that the Commission's past decisions have applied the net asset value principle only when there were "other viable alternatives" (than merger) by which an investment company may "realize its net asset value" (Pet. App. 63a–64a). As noted above, tax and market considerations foreclose such alternatives here. In no case, however, has the Commission required a showing of such alternatives as a condition for approving under Section 17(b) the terms of a merger based upon the net asset value of an investment company.[24]

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[22] *Talley Industries, Inc.*, Investment Company Act Release No. 5953 (1970) (operating companies). Section 17 applied because both companies are affiliated with the same investment company.

[23] *Electric Bond and Share Co.*, Investment Company Act Release No. 5215 (1967); *Southeastern Capital Corp.*, Investment Company Act Releases Nos. 4110 and 4133 (1964 and 1965); *New York Dock Co.*, 38 S.E.C. 754; *Century Investors, Inc.*, 40 S.E.C. 319. The last cited case was in any event based on net asset value. *Id.* at 324.

[24] No such alternatives were shown in *Huyler's*, Investment Company Act Releases Nos. 5773 and 5809 (1969); *Eastern States Corporation*, Investment Company Act Releases Nos.

The court relied heavily upon *Delaware Realty and Investment Company*, 40 S.E.C. 469 (Pet. App. 63a–64a). The passage quoted, however (40 S.E.C. at 473), did not reflect the Commission's reasoning. It simply recounted what the record revealed—that the merging parties considered the availability of alternatives as another element favoring net asset value. *Ibid.* Indeed, the alternative means by which Delaware Realty might have realized its net asset value without a merger also would have required the cooperative efforts of the two parties to the merger (*id.* at 470, 473). Accordingly, that case does not hold, or imply, that the reasonableness and fairness standard of Section 17(b) requires that in a transaction with its affiliate the investment company is to be valued on net asset value only when there are alternative methods of achieving the same result.

In light of the foregoing, the Commission's settled interpretation, reflecting, as it does, the "construction of a statute by those charged with its execution [,] should be followed unless there are compelling indications that it is wrong." [25]

5693 and 5711 (1969); *Harbor Plywood, supra;* or Detroit and *Cleveland Navigation Company*, Investment Company Act Releases Nos. 3082 and 3099 (1960). In *Baldwin Securities Corp.*, Investment Company Act Releases Nos. 7045 and 7120 (1972), and *Century Investors, Inc.*, 40 S.E.C. 319, the Commission found merger terms based on net asset value to be fair even though the record was clear that no financially viable alternatives to the proposed transactions existed.

[25] *Red Lion Broadcasting Co.* v. *Federal Communications Commission*, 395 U.S. 367, 381, quoted with approval in *New York Dept. of Social Services* v. *Dublino*, 413 U.S. 405, 421. See also *Udall* v. *Tallman*, 380 U.S. 1, 16–18.

CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded to that court with instructions to affirm the Commission's order.

Respectfully submitted.

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